87-1952

NO.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

RALPH K. VANLANDINGHAM,
PETITIONER

v.

COMMISSIONER OF
INTERNAL REVENUE,
RESPONDENT

PETITION FOR WRIT OF CERTIORARI

TO REVIEW A DECISION OF

THE UNITED STATES COURT OF APPEALS

FOR THE FOURTH CIRCUIT

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QUESTIONS PRESENTED

FOR REVIEW

WHETHER THE FOURTH CIRCUIT COURT OF APPEALS HAS DECIDED A FEDERAL QUESTION IN A WAY IN CONFLICT WITH APPLICABLE DECISIONS OF THIS HONORABLE COURT BY AFFIRMING THE RULING OF THE TAX COURT THAT THE PETITIONER IN THE INSTANT CASE CANNOT BENEFIT FROM THE NONSEVERABILITY RULE STATED IN THE ESTATE OF <u>MELNICK V. COMMISSIONER</u>, A TAX COURT CASE ALSO INVOLVING THE SALE OF AN ACCOUNTING PRACTICE, BECAUSE IN <u>MELNIK</u> THE "PURCHASE AGREEMENT . . . CONTAINED NO ALLOCATION OF THE PURCHASE PRICE" TO THE COVENANT NOT TO COMPETE."

LIST OF PARTIES

The caption of the case in this Court contains the names of all parties.

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JURISDICTIONAL STATEMENT

1. The date of the judgment or decree sought to be reviewed is January 4, 1988.

2. The date of the order denying the Petition for Rehearing - Suggestion for Rehearing En Banc is February 25, 1988.

3. The statutory provision conferring on this Court jurisdiction to review the judgment or decree in question by writ of certiorari is 28 U.S.C. Section 2101(c).

APPLICABLE STATUTES

Section 1221 of the Internal Revenue Code of 1954, as amended.

SEC. 1221. CAPITAL ASSET DEFINED

For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include-

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

(2) property, used in his trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or real property used in his trade or business;

(3) a copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property, held by-

(A) a taxpayer whose personal efforts created such property,

(B) in the case of a letter,

memorandum, or similar property, a taxpayer for whom such property was prepared or produced, or

(C) a taxpayer in whose hands the basis of such property is determined, for purposes of determining gain from a sale or exchange, in whole or part by reference to the basis of such property in the hands of a taxpayer described in subparagraph (A) or (B);

(4) accounts or notes receivable acquired in the ordinary course of trade or business for services rendered or from the sale of property described in paragraph (1);

(5) a publication of the United States Government (including the Congressional Record) which is received from the United States Government or any agency thereof, other than by purchase at the price at which it is offered for sale to the public, and which is held by-

(A) a taxpayer who so received such publication, or

(B) a taxpayer in whose hands the basis of such publication is determined, for purposes of determining gain from a sale or exchange, in whole or in part by reference to the basis of such publication in the hands of a taxpayer described in subparagraph (A).

Section 1202 of the Internal Revenue Code of 1954, as amended.

Section 1202. **DEDUCTION FOR CAPITAL GAINS.**

(a) **In general.-** If for any taxable year a taxpayer other than a corporation has a net capital gain, 60 percent of the amount of the net capital gain shall be a deduction from gross income.

STATEMENT OF THE CASE

This case came to be heard on appeal by the United States Court of Appeals for the Fourth Circuit Court following the Tax Court's decision in **VanLandingham v. Commissioner**, 56 T.C.M. (P-H), T.C. Memo 1987-66 (1987).

In **VanLandingham v. Commissioner**, the Tax Court addresses the issue of how $200,000 of $250,000 to be paid to Ralph K. VanLandingham by Robert Braun upon the sale of VanLandingham's interest in the accounting practice conducted by VanLandingham, Braun & Company, a partnership, is to be allocated for federal income tax purposes.

To the extent that the $200,000 is allocable to the good will represented by the client base of 300 clients built up by VanLandingham (see Stipulation 13,

Appendix, at IV-13) and not a five year covenant not to compete agreed to by VanLandingham as part of the purchase agreement (see Section 13 of the purchase agreement, **Appendix**, at IV-13), VanLandingham sold Braun an intangible qualifying as a capital asset under Section 1231 of the Internal Revenue Code of 1954, as amended.

To the extent any part of the purchase price is allocable to good will, and, thus, to a capital asset, VanLandingham realizes a long term capital gain of which, pursuant to Section 1202 of the Internal Revenue Code of 1954, as amended, only 40% is taxable while Braun incurs an acquisition cost which is not deductible for federal income tax purposes.

According to Section 2 of the

Agreement, the $200,000 was payable for the

> . . . the remaining interest of VanLandingham in VANLANDINGHAM, BRAUN & COMPANY, consisting of VanLandingham's interest in all intangible assets including but not limited to the right to service all clients, non-competition agreement and client files . . . ."

Appendix, at V-4.

Section 3 of the purchase agreement stated the following:

> VanLandingham agrees to treat the sum of TWO HUNDRED THOUSAND and no/100 DOLLARS 200,000.00) as ordinary income and Braun agree to treat the sum as ordinary deduction.

Appendix, at V-4.

Section 4 of the purchase agreement made the following reference to the allocation of purchase price under Section 2 of the agreement:

> The parties declare that these values were determined in good faith as the result of arm's length bargaining. The parties make the foregoing allocation of purchase price to the capital account of VanLandingham in VANLANDINGHAM, BRAUN & COMPANY, ($50,000.00), and VanLandingham's share in the noncapital assets in VANLANDINGHAM, BRAUN & COMPANY ($200,000.00), with the knowledge and understanding that it will be used by Braun and VanLandingham for income tax purposes.

Appendix, at V-6.

Section 12 of the purchase agreement stated that in connection with the VanLandingham's transfer to Braun of the client base comprised of 300 clients that

> . . . Braun agrees that VanLandingham has given his best efforts in good faith to promote the transfer of clients from VANLANDINGHAM, BRAUN & COMPANY to Braun. Braun acknowledges that VanLandingham has personally talked with all major clients

> of VANLANDINGHAM, BRAUN & COMPANY in Braun's presence to promote the said client transfer and that VanLandingham has mailed a letter approved by Braun to all other clients, a copy of said letter is attached hereto as Exhibit D. Braun agrees that VanLandingham has fulfilled his obligation to promote the transfer of clients.

Appendix, at V-12.

The purchase agreement entered into by VanLandingham and Braun identified $50,000 of the $250,000 purchase price which was paid in cash, at closing or shortly thereafter, as a payment made for VanLandingham's capital account, that is, as a payment equal to VanLandingham's cash investment in the partnership plus any income of the partnership which had been taxed to VanLandingham, but which had not been distributed to him.

The remaining $200,000 payable

under the purchase agreement, the amount at issue, was paid with two notes bearing interest of 7 and 1/2% and requiring principal payments of $13,333 for 15 years.

The issue before the Tax Court, as noted above, was whether the government on audit was correct in allocating this remaining $200,000 to the five year covenant not to compete which VanLandingham entered to as part of the agreement and, accordingly, giving ordinary income treatment to $75,000 received by VanLandingham during the two taxable years in question.

The $75,000 was a settlement amount agreed to by the parties at a time when Braun still owed $160,000 on the notes and was unable to meet the payments required under the notes.

The cash for the settlement was provided by Braun's father who bought the notes from VanLandingham pursuant to an agreement signed by Braun's father, Braun's wife, and Braun which stated that VanLandingham would no longer be restrained by the covenant not to compete and that VanLandingham would treat the $75,000 as capital gain.

The $75,000 was payable in two installments, one in the amount of $21,750 which was paid in the taxable year ending June 30, 1980 and the other in the amount of $53,250 which was paid during the taxable year ending June 30, 1981.

VanLandingham treated both payments as capital gains and, accordingly, on the two returns in question reported a total of $30,000 as taxable gain (40% of

$75,000).

On June 11, 1984, the Commissioner of the Internal Revenue issued a Notice of Deficiency to VanLandingham which in relevant part disallowed the 60% long term capital gains deduction claimed with respect to the $75,000 amount in question. VanLandingham appealed the Commissioner's determination to the United States Tax Court.

In it decision handed down on February 2, 1987, The Tax Court sustained the Commissioner's determination that the entire $200,000 was allocable to the covenant not to compete.

Chief among the Tax Court's finding of facts was the finding that the purpose of the covenant not to compete was to protect the income stream

generated by the extensive client base Braun was purchasing:

> By applying the standard [requiring proof under Virginia law of the existence of a "legitimate business interest"], we find the covenant not to compete is enforceable under the laws of Virginia. **Braun's "business interest" underlying the covenant not to compete was preservation of the income stream generated by the partnership. The purpose of the covenant was to protect that income stream by preventing petitioner from providing competing services in the same general area as existing partnership clients.**

Appendix, at III-19. (Emphasis added.)

The case was appealed to the Fourth Circuit Court of Appeals. The reviewing panel affirmed the Tax Court's decision.

The per curiam opinion of the panel issued on January 4, 1988 affirmed the decision of the Tax Court to allocate 100% of the $200,000 stated

contract price in question to the covenant not to compete. The Court of Appeals described the Tax Court's decision in the following way:

> The Tax Court reviewed the evidence considering the intent of the parties and the economic realities of the transaction. Based on those considerations, it determined that the $200,000 was meant to be allocated to the noncompetition agreement and that this intent reflected the economic realities faced by Braun and VanLandingham in their negotiations. The court therefore concluded that the $200,000 was ordinary income, and the $75,000 paid in lieu of it was the same.

Appendix, at II-3.

The opinion states that the Panel affirms the decision of the Tax Court on the following basis:

> We affirm the Tax Court's decision on the basis of the opinion below and our previous decision in General Ins. Agency v. Commissioner, 401 F. 2d 324 (4th Cir. 1968).

(Id.)

VanLandingham then filed a Petition for Rehearing - Suggestion for Rehearing En Banc. The order stating that the Petition for Rehearing was not granted was issued on February 25, 1988.

SPECIFICATION OF STAGE
OF STATE COURT PROCEEDING

Not applicable.

BASIS FOR FEDERAL JURISDICTION

IN THE COURT OF FIRST INSTANCE

Section 7442 of the Internal Revenue Code of 1986, as amended.

ARGUMENT AMPLIFYING REASONS
OF THE WRIT OF CERTIORARI

I

ARGUMENT

THE FOURTH CIRCUIT COURT OF APPEALS HAS DECIDED A FEDERAL QUESTION IN A WAY IN CONFLICT WITH APPLICABLE DECISIONS OF THIS HONORABLE COURT BY AFFIRMING THE RULING OF THE TAX COURT THAT THE PETITIONER IN THE INSTANT CASE CANNOT BENEFIT FROM THE NONSEVERABILITY RULE STATED IN THE ESTATE OF MELNICK V. COMMISSIONER, A TAX COURT CASE ALSO INVOLVING THE SALE OF AN ACCOUNTING PRACTICE, BECAUSE IN MELNIK THE "PURCHASE AGREEMENT . . . CONTAINED NO ALLOCATION OF THE PURCHASE PRICE" TO THE COVENANT NOT TO COMPETE."

It is respectfully submitted that in affirming **VanLandingham v. Commissioner**, ____ T.C.M. (P-H) 308, T.C. Memo 1987-66 (1987), the Fourth Circuit Court of Appeals "has decided a federal question in a way in conflict with applicable decisions of this Court." **Rule 17.1(c).**

It is, accordingly, respectfully requested that this Court grant a writ of certiorari to review the decision of the Fourth Circuit.

I.A

THE APPLICABLE DECISIONS OF THIS COURT

The applicable decisions of this Court with which the Fourth Circuit's ruling conflicts are the time honored tax opinions handed down in **Eisner v. Macomber**, 252 U.S. 189, 206 (1919), **Weiss v. Stearn**, 265 U.S. 242, 253 (1926), and **Gregory v. Helvering**, 293 U.S. 464 (1935).

In these cases, this Court was engaged in articulating the basic principles to be employed in deciding disputes between taxpayers and the

Commissioner of Internal Revenue.

When **Eisner v. Macomber** was decided, the Sixteenth Amendment to the Constitution of the United States (ending the controversy whether the taxation of income was unconstitutional as an unapportioned, direct tax) had been law for only three years.

One overriding basic principle which found expression in these cases and which has never been abandoned by this Court is the principle that the **substance** of a transaction will govern the tax consequences which follow from it, **not its form**.

In **Eisner v. Macomber**, at 206, this Court, in addressing the issue whether a stock dividend constituted income for federal income tax purposes, stated that whether an item is or is not to be

considered "income" will be decided **"according to truth and substance, without regard to form."** (Emphasis added.)

Subsequently, in **Weiss v. Stearn**, 265 U.S. 242, 253 (1926) this Court generalized its recognition of the primacy of the substance of a transaction when deciding a case which is determinative of a federal income tax liability by making the following statement:

> Questions of taxation must be determined by viewing **what was actually done, rather than the declared purpose of the participants**; and when applying the provisions of the Sixteenth Amendment and income laws enacted thereunder we must regard matters of **substance** and **not** mere **form.**

(Emphasis added.)

Again, in **Gregory v. Helvering**, the

Commissioner of the Internal Revenue prevailed on the claim that the taxpayer had realized ordinary income rather than long term capital gain (upon the liquidation of a subsidiary created incident to a purported reorganization of the parent corporation) when this Court agreed with the Commissioner that

> ". . . the reorganization attempted was without substance and must be disregarded . . ." [and that] ". . . to hold otherwise would be to exalt artifice above reality . . ."

Gregory v. Helvering, at 467, 469.

The principle of substance over form as applied in these and subsequent cases is a principle which does not favor either the Commissioner of Internal Revenue. In some cases, it been advantageous to the taxpayer, while in others, its application has been to

the advantage of the Commissioner.

For example, in **Eisner v. McComber** and **Weiss v. Stearn**, deciding the case "according to truth and substance, without regard to form" proved advantageous to the taxpayer, while in **Gregory v. Helvering** it was decidedly to the Commissioner's advantage.

It is submitted that, the Fourth Circuit, in affirming the decision of the Tax Court to withhold from the Petitioner the benefits of the nonseverability rule has "exalted artifice above reality" and has, accordingly, decided a federal question in a way in conflict with applicable decisions of this Court.

In order to properly present this position to the Court, it is necessary first to provide a brief explanation of

the nature, origin, and effect of the nonseverability rule.

I.B.

THE NONSEVERABILITY RULE

The nonseverability rule provides that, in the context of the purchase of a business or an interest in a business where good will is being purchased, if value is given for a covenant not to compete and the purpose of the covenant is to protect the good will purchased, then the covenant not to compete is nonseverable from the good will and, as such, the proper allocation of the price paid for the covenant not to compete should be allocated entirely to the good will.

See **The Estate of Leo Melnik v. Commissioner**, 20 T.C.M. (P-H) 74, T.C.

Memo 1961-18 (1961) [sale of an interest in an accounting practice], affirmed in **Karan v. Commissioner**, 319 F.2d 303 (7th Cir. 1963); **Masquelette v. Commissioner**, 239 F.2d 322 (5th Cir. 1956) [sale of an interest in an accounting practice]; Aaron Michaels, 12 T.C. 17 (1949) [sale of an interest in an accounting practice]; and **Toledo Blade Newspaper Co. v. Commissioner**, 2 T.C. 794 (1943).

The origin of the nonseverability rule is the **Toledo Blade Newspaper Co.** case and it is in this case that the rationale underlying the rule is stated.

In the **Toledo Blade Newspaper Co.** case, of a total purchase price of $880,000.00, a total of $780,000.00 was expressly allocated to the covenant not to compete under the written agreement entered into by the parties and nothing

was allocated to the good will. Toledo Blade Newspaper Co., at 797.

In addition, the allocation was entered into on the basis of tax consequences which were bargained for between the parties. Toledo Blade Newspaper Co., at 798.

The Tax Court found, nonetheless, that 100% of the purchase price was allocable to the good will because the purpose of the covenant not to compete was to protect the good will purchased.

The court in Toledo Blade explained its decision by stating that in a context where the covenant not to compete is entered into "to prevent the seller from destroying the value of the good will of the business transferred", the covenant not to compete becomes "an inherent part" of the good will and

that, consequently, the "entire consideration" received for intangible assets is allocable to the good will. **Toledo Blade Newspaper Co., at 806.**

In the **Michaels** case, the Tax Court, finding in the context of the sale of an accounting practice that the purchase price at issue was entirely allocable to the good will, explained the **Toledo Blade Newspaper Co.** nonseverability rule by stating that where the purpose of the covenant not to compete is to protect the good will purchased, it becomes in effect "a contributing element to the assets [the good will] transferred" and on this account is nonseverable from the good will. **Michaels v. Commissioner**, at 19.

One commentator cited and paraphrased by the Court of Claims in

Forward Communications Corp. v. United States, 608 F.2d 485 (1979) focusing on the tax effects of the nonseverability rule (see Statement of the Case, p. ___), namely, that the amount at issue while taxable to the seller is nonamortizable or nondeductible by the buyer states that this result is reasonable since the benefit of the covenant is the **continued** (that is, beyond the term of the covenant) enjoyment of the good will.

> One rationale for the application of such test, at least with respect to deductions by the purchaser, as is the issue herein, is that where the goodwill and the covenant are closely related the benefits of the elimination of competition may be permanent or of indefinite duration and hence the value of the covenant is not exhaustible or a wasting asset to be amortized over a limited period. **See 4 J. Mertens, Law of Federal Income Taxation**

Section 23.68 (1973 rev.)

. . . .

Id., at 489.

I.C.
THE RESTRICTIVE STATEMENT OF THE NONSEVERABILITY RULE AFFIRMED BY THE FOURTH CIRCUIT

On appeal to the Fourth Circuit and at trial before the Tax Court, the chief argument of Petitioner was that since the purpose of the covenant not to compete was to protect the good will, it followed from the nonseverability rule as articulated in **Toledo Newspaper Company, Inc.** (and applied in the **Melnick** case in the context of the sale of an interest in an accounting firm) that the $200,000 stated contract price at issue in the instant case was properly allocable to the good will.

In **Melnik v. Commissioner**, the Tax Court found that the entire purchase

price at issue was allocable to the good will purchased. In explaining its decision, the court invoked the nonseverability rule. The court stated, citing the **Michaels** case (another case involving the sale of an accounting practice) and the **Toledo Blade Newspaper Co.** case, that since the purpose of the covenant not to compete was to protect the good will represented by the interest in the accounting firm being purchased, then

> . . . we conclude that the covenant was not severable from the sale of good will and that no separate part of the consideration is attributable thereto.

Melnik v. Commissioner, p. 77.

The Tax Court explained its application of the nonseverability rule by quoting the following from the **Michaels** case:

> But where it [the agreement not to compete] accompanies the transfer of good will in the sale of a going business and it is apparent that the covenant not to compete has the function primarily of assuring to the purchase the beneficial enjoyment of the good will which he has acquired, the covenant is regarded as nonseverable and as being in effect a contributing element to the assets transferred. **Toledo Newspaper Co.**, 2 T.C. 794; **Toledo Blade Co.**, 11 T.C. 1079.

Michaels v. Commissioner, at 19.

The question, then, is Why the Court of Appeals **despite a central finding of fact by the Tax Court that the covenant not to compete served to protect the good will** purchased under the agreement affirmed the Tax Court's decision to disregard Petitioner's position that it must as a result of that finding apply the nonseverability rule stated in **Melnik** to the facts of

the instant case? - with the result that the purchase price in question is allocable to the good will represented by client base of 300 clients, not to the covenant not to compete entered into, as the Tax Court found, "to protect the income stream generated by" that client base?

Part of the answer is found in this portion of the Tax Court's opinion affirmed by the Fourth Circuit:

> **Melnik** is . . . **distinguishable from the instant case** . . . [because] . . . the purchase agreement . . . contained no allocation of the purchase price to the assets transferred. **In this case, the sales agreement specifically allocated the purchase price** among two groups of assets, on which was referred to as the "capital account" of VanLandingham and the second of which was referred to as "VanLandingham's share in the noncapital assets in" the company.

Appendix, at III-31. Emphasis added.

An additional source of the application of this restrictive statement of the nonseverability rule is found in the Fourth Circuit case, **General Insurance Agency, Inc. v. Commissioner**, 401 F.2d 324 (4th Cir. 1968).

In that case, a decision not disavowed by the Fourth Circuit in the instant case, the court while citing **Toledo Blade Newspaper Co. v. Commissioner**, stated a similarly restrictive version of the nonseverability rule:

> If the payments [are] for a covenant not to compete they would constitute ordinary income . . . and an amortizable expense . . . [Citations omitted.] However, generally, if such a covenant is not separately bargained for and accounted for and is merely incidental to the

> transfer of the over-all business the seller will be entitled to capital gains treatment of the entire proceeds of the sale but the buyer will get no deduction. **Hamlin's Trust v. C.I.R.**, 209 F.2d 761 (10 Cir. 1954), aff'g 19 T.C. 718 (1953); **Lee Ruwitch**, 22 T.C. 1053 (1954); **Toledo Newspaper Co.**, 2 T.C. 794 (1943).

General Insurance Agency, Co. v. Commissioner, at 329.

This statement of the nonseverability rule by the Fourth Circuit states that the benefit of the rule is available only if the complaining party, in addition to proving that the covenant not to compete serves to protect the good will purchase, also proves that the covenant not to compete is not separately bargained for and is not separately accounted for.

A finding then that a sales

agreement specifically allocated an amount to the covenant not to compete would constitute proof that the covenant was both separately bargained for and separately accounted for - the result being that the nonseverability rule would not be found to be applicable.

This restrictive statement of the nonseverability rule, as will be discussed in detail under I.D., below, completely disregards the rationale of the nonseverability rule as articulated in **Toledo Blade Newspaper Co.**, the case in which the rule originated. As such, as will also be discussed, it is in conflict with the principle announced by this Court in **Eisner v. McComber**, **Weiss v. Stearn**, and **Gregory v. Helvering** that issues relating to the liability for federal income tax shall be decided

"according to truth and substance, without regard to form."

I.D.

The Petitioner submits that this rule contradicts the statement of the nonseverability rule given in the **Toledo Blade Newspaper Co.**, the case in which the rule was originally stated.

In the **Toledo Blade Newspaper Co.** case, the Tax Court allocated 100% ($780,000) of the purchase price at issue despite the circumstances that exactly that amount had been expressly allocated to the covenant not to compete under the sales agreement and that this express allocation was the result of bargaining over tax consequences.

The deciding factor to the Tax Court in **Toledo Blade Newspaper Co.**,

Inc. was that the covenant not to compete was entered into to protect the good will and as such became "an inherent part" of the good will and so should be viewed as nonseverable from it. **Toledo Blade Newspaper Co., at 806.**

Similarly, in **Masquelette v. Commissioner**, where the Fifth Circuit found that the purchase price at issue was entirely allocable to the good will purchased since the covenant not to compete entered into incident to the sale of an accounting practice served

> . . . to assure that the entire good will . . . would be effectively conveyed, . . . the agreement not to compete is a non-severable part of the conveyance of the good will" with the consequence that the purchase price at issue is to be allocated to the good will.

Masquelette v. Commissioner, at ___.

The Tax Court in **Melnik**, citing

Horton v. Commissioner, 13 T.C. 143 (1949), defined good will as being "nothing more than the probability that the old customers will resort to the old place" and, thus, the probability that the income stream generated by those customers or clients will continue uninterrupted.

In **Melnik**, the extent to which an accountant may be viewed as transferring good will was viewed by the 7th Circuit on review as being directly correlated with the extent to which the existing clientele at the time of the sale was attributable to the efforts of the selling partner. **Karan et al. v. Commissioner**, at 306.

In the instant case, Stipulation 13 shows that the client base of 300

clients was attributable to the efforts of VanLandingham and not to Braun, an accountant with three and one half years of experience (see Stipulation 12). **Appendix**, at IV-13.

Given this definition of good will, the Tax Court in the instant case in expressly finding that Braun's business interest underlying the covenant not to compete was entered into to protect the "income stream generated by the partnership" made a finding that the covenant not to compete was entered into to protect the good will.

This finding of fact, fully stated, reads as follows:

> Braun's "business interest" underlying the covenant not to compete was preservation of the income

> **stream generated by the partnership.** The purpose of the covenant was to **protect that income stream** by preventing petitioner from providing competing services in the same general area as existing partnership clients.

Appendix, at III-19. (Emphasis added.)

(The quotation marks around "business interest" were employed by the Tax Court to indicate that its finding tracked the rule of law governing the enforceability of covenants not to compete under Virginia law, a rule which stated that for a covenant not to compete to be enforceable, it must, among other things, protect the "buyer in some legitimate business interest." Id.)

From this central finding by the Tax Court that the business reality of the covenant not to compete is that it serves to protect the good will, it

follows from the **Melnik** decision that the covenant not to compete in the instant case is nonseverable from the good will.

It was because the covenant not to compete served to protect the good will transferred under the purchase agreement, that the Tax Court in **Melnik** " . . . conclude[d] that the covenant was not severable from the sale of good will and that [,accordingly,] no part of the consideration is attributable thereto." **Melnik**, at 77.

Under the Tax Court's application of the rule in **Melnik**, it is not a finding of fact that the underlying business purpose of the covenant is to protect the good will being transferred which is dispositive of whether the covenant is nonseverable from the good

will; what controls on the Tax Court's view as affirmed by the Fourth Circuit is the presence or absence in the purchase agreement of a stated allocation to the covenant not to compete stated in the sales agreement.

If the agreement is silent as to an allocation to a covenant not to compete, then the nonseverability of the covenant from the good will which follows from a finding of fact that the covenant protects the good will results in the purchase price at issue being allocated to the good will.

If, however, the agreement states that the purchase price at issue is allocable to the covenant not to compete, then a finding of fact (the same finding of fact) by the court that the covenant not to compete protects the

good will does not somehow result in the covenant's being nonseverable from the good will.

The specific allocation of purchase price to a covenant not to compete, the purpose of which is to protect the good will, obviously does nothing to alter that purpose; and since it is precisely the circumstance that the purpose of a covenant not to compete protects the good will that results in that covenant's being an inherent part of the good will, such a specific allocation does nothing to alter that covenant's being an inherent part of the good will. The restrictive statement of the nonseverability ignores this circumstance.

In applying the restrictive nonseverability rule by recognizing as

dispositive any specific allocation of purchase price to the covenant not to compete, the Fourth Circuit is allowing mere words to create an independent significance for the covenant not to compete.

A leading commentator, Mertens, gives the same analysis:

> If an agreement not to compete is necessary to effectuate a transfer of goodwill, then the payments made under it may be treated as if made for the sale of a capital asset. It is difficult to understand as a matter of economic reality how, in this kind of case, such a covenant can be anything except "nonseverable" or "ancillary," regardless of whether or not the parties segregate or deal with it as a separate item, since in either event the function of the covenant is to protect the assets transferred and enters into the goodwill . . . .

3B J. Mertens, Law of Federal Income Taxation Sec. 22.33 [p. 303] (____

rev.). (Emphasis added.)

One of the more surprising circumstances arising from this controversy is the government's resistance to the nonseverability rule as stated in the **Toledo Blade Newspaper Co.** case.

One of the most frequent, major business transactions for small businesses, businesses in which, as in this case, considerable good will is present, is the ultimate sale of the business enterprise.

Even though the seller is taxed whether he receives money for good will or for a covenant not to compete, the federal Treasury is allowed to keep the tax paid only if the allocation is to good will. Only then is the money paid by the buyer nondeductible and, thus, is

not paid to the buyer in the form of tax savings.

Where the allocation is to the covenant not to compete, the taxes paid into the Treasury by the seller are paid out to the buyer in the form of tax savings or tax refund.

In affirming the Tax Court's finding, the Fourth Circuit is deciding a federal question in conflict with applicable decisions of this Court, namely, **Eisner v. McComber, Weiss v. Stearn**, and **Gregory v. Helvering**, by allowing the form of a transaction rather than its substance to govern the tax consequences which result from the transaction.

No rule of law could be more dependent on form than the restrictive statement of the nonseverability rule.

and, thus, no rule of law could be more antagonistic to the principles of substance over form stated by this Court in **Eisner v. McComber** and amplified in **Weiss v. Stearn** and **Gregory v. Helvering.**

The Fourth Circuit has affirmed a rule which will result in upholding allocations to the covenant not to compete even where, as in the instant case, the Tax Court makes a **finding of fact** that the buyer's "business interest" is to "protect . . . [the] **the income stream generated by the partnership . . .** by preventing petitioner from providing competing services in the same general area as **existing partnership clients."** **Vanlandingham, Appendix** at III-19.

For the Fourth Circuit to allow

this result by affirming the Tax Court and by not repudiating its own restrictive statement of the nonseverability rule in the **General Insurance Agency, Inc.** case is by elevating form over substance to allow individual taxpayers to determine how tax law will apply to them by contract. A circumstance which this Court has stated it will not allow. **Bartels v. Birmingham, Collector of Internal Revenue**, 332 U.S. 126 (1947). The restrictive statement of the nonseverability upheld by the Fourth Circuit "extols artifice above reality."

CERTIFICATE OF SERVICE

I hereby certify that five true copies of the Petition for Writ of Certiorari was mailed, postage prepaid, on this the 25th day of May, 1988 to Michael L. Paup, Esq., Chief, Appellate Section, Michael Cavalier Durney, Esq., Linda E. Mosakowski, Esq., Gilbert Stephen Rothenberg, Esq., and Margaret Elizabeth Clark, Esq.-at the following address: Tax Division, Department of Justice, P. O. Box 502, Washington, D.C. 20044.

C. Richard Davis

C. Richard Davis, Esq.
Counsel for Ralph K. VanLandingham

87-1952

NO.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

APPENDIX

RALPH K. VANLANDINGHAM,
PETITIONER

v.

COMMISSIONER OF
INTERNAL REVENUE,
RESPONDENT

PETITION FOR WRIT OF CERTIORARI

TO REVIEW A DECISION OF

THE UNITED STATES COURT OF APPEALS

FOR THE FOURTH CIRCUIT

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APPENDIX

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UNITED STATES COURT OF APPEALS

FOR THE FOURTH CIRCUIT

No. 87-1604

Ralph K. VanLandingham,
Plaintiff-Appellant

versus

Commissioner of Internal Revenue,
Defendant-Appellee

On Petition for Rehearing with Suggestion for Rehearing in Banc.

O R D E R

The appellant's petition for rehearing and suggestion for rehearing in banc were submitted to this Court. As no member of the Court requested a poll on the suggestion for rehearing in banc, and

As the panel considered the petition for rehearing and is of the

opinion that it should be denied,

IT IS ORDERED that the petition for rehearing and suggestion for rehearing in banc are denied.

Entered at the direction of Judge Ervin, with the concurrence of Judge Wilkinson and Judge Wilkins.

For the Court,

____
Clerk

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 87-1604

Ralph K. VanLandingham,
Plaintiff-Appellant,

versus

Commissioner of Internal Revenue,
Defendant-Appellee.

Appeal from the United States Tax Court. Judge Drennen, Tax Court Judge. (Tax Ct. No. 34883-84)

Argued: December 2, 1987
Decided: January 4, 1988

Before ERVIN, WILKINSON, AND WILKINS, Circuit Judges.

Charles Richard Davis for Appellant; Linda E. Mosakowski, United States Department of Justice, Tax Division (Michael C. Durney, Acting Assistant Attorney General; Michael L. Paup; Gilbert S. Rothenberg on brief) for Appellee.

PER CURIAM:

Appellant Ralph K. VanLandingham appeals from a deficiency

order entered by the Tax Court. We affirm.

VanLandingham sold his interest in an accounting partnership to his partner, Robert Braun, in 1976 for $250,000. The sales agreement provided that $50,000 was payable immediately while the other $200,000 would be paid over fifteen years. The agreement stated that $200,000 would be treated as ordinary income by VanLandingham and an ordinary expense deduction by Braun, and it also included a covenant by VanLandingham not to compete for five years.

A subsequent agreement in 1980 between VanLandingham, Braun, and Braun's father-in-law superseded the original agreement. Two payments

totaling $75,000 from the father-in-law

replaced the unpaid balance of $160,000 from the initial agreement, and it released VanLandingham from the noncompetition agreement. It also stated that VanLandingham would treat the $75,000 as capital gains, which he did.

The Internal Revenue Service disputed this treatment and issued a notice of deficiency. The Tax Court tried the case based on a fully stipulated record, and the sole issue at trial was the approariate tax treatment of the $75,000. The court determined that it was ordinary income and issued a deficiency order. VanLandingham appeals.

The Tax Court reviewed the

evidence considering the intent of the parties and the economic realities of the transaction. Based on those considerations, it determined that the $200,000 was meant to be allocated to the noncompetition agreement and that this intent reflected the economic realities faced by Braun and VanLandingham in their negotiations. The court therefore concluded that the $200,000 was ordinary income, and the $75,000 paid in lieu of it was the same.

We affirm the Tax Court's decision on the basis of the opinion below[1] and our previous decision in General Ins. Agency v. Commissioner, 401 F.2d 324 (4th Cir. 1968). The decision of the Tax Court is

AFFIRMED.

1 We do not necessarily endorse, however, the Tax Court's application of the strong proof rule, or its reliance on the failure to expressly reference "good will" in the sales agreement.

T. C. Memo. 1987-66

UNITED STATES TAX COURT

RALPH K. VANLANDINGHAM,

Petitioner,

_v_. COMMISSIONER OF INTERNAL REVENUE,

Respondent

Docket No. 343883-84.

Filed February 2, 1987.

Petitioner sold his interest in an accounting partnership to his partner for $250,000. The agreement of sale provided that petitioner agreed to sell his "capital account" in the firm for

$50,000 and his remaining interest in the firm "consisting of VanLandingham's interest in all intangible assets including but not limited to the right to service all clients, noncompetition agreement and client files" for $200,000. Petitioner agreed to treat the $200,000 as ordinary income and the purchaser agreed to treat the sum as "ordinary deduction."

Held: The $200,000 was to be paid for a covenant not to compete and payments with respect thereto were taxable as ordinary income to petitioner.

B. Roland Freazier, Jr.,
Gary S. Cook and
C. Richard Davis, for the petitioner.

Scott Anderson, for the respondent.

MEMORANDUM OPINION

DRENNEN, Judge: Respondent determined deficiencies in Petitioner's Federal income tax and additions to tax as follows:

Year	Income Tax Deficiency
June 30, 1980	$ 2,609.41
June 30, 1981	10,085.60

Year	Additions to Tax Sec.6651(a)[1/]	Sec.6653(a)
June 30, 1980	$130.47	$2,521.40
June 30, 1981	-0-	504.28

This case was submitted fully stipulated. The stipulation of facts and exhibits attached thereto are incorporated herein by this reference.

Facts related herein were stipulated by the parties or are derived from the stipulated exhibits.

Petitioner filed U. S. Individual Income Tax returns for fiscal years ended June 30, 1980 and 1981, with the Memphis Service Center on February 23, 1981 and June 7, 1982, respectively.

After concessions,2/ the only remaining issue in this case is whether certain proceeds petitioner received from the sale of his interest in an accounting partnership are ordinary income or capital gain.

On December 16, 1975, Ralph K. VanLandingham (hereinafter referred to as "petitioner") and Robert L. Braun (hereinafter referred to as "Braun"), organized a partnership known as VanLandingham, Braun & Company

(hereinafter referred to as "the partnership") to provide accounting services to the general public. Partnership revenues were derived from the provision of accounting services to individuals and businesses located in Gloucester, Middlesex, Northumberland, King and Queen, and King William counties of Virginia. No services were provided in York, Richmond, Westmoreland, or Essex counties.

On November 13, 1976, petitioner and Braun entered into an agreement (hereinafter referred to as "sales agreement"), wherein petitioner agreed to sell his interest in the partnership to Braun for $250,000. Sale of the partnership closed on or about November 15, 1976.[3] The sales agreement

provided that Braun would pay the purchase price by making a cash payment of $25,000 and executing, along with his wife, Cynthia, a note payable to petitioner for $25,000 due March 1, 1977, and notes payable to petitioner for $50,000 and $150,000, with regard to which principal payments of $3,033.33 and $10,000, respectively, were payable annually commencing July 1, 1977, and ending July 1, 1991.

The sales agreement provided in relevant part as follows:

> 1. Braun agrees to purchase and VanLandingham agrees to sell the capital account of VanLandingham in the firm of VANLANDINGHAM, BRAUN & COMPANY for the sum of FIFTY THOUSAND AND NO/100 DOLLARS ($50,000.00), upon the terms and conditions of this Agreement as a whole, payable as follows: ***
>
> 2. Braun agrees to purchase and VanLandingham agrees to sell the remaining interest of

VanLandingham in VANLANDINGHAM, BRAUN & COMPANY, consisting of VanLandingham's interest in all intangible assets including but not limited to the right to service all clients, noncompetition agreement and client files, for the sum of TWO HUNDRED THOUSAND and no/100 DOLLARS ($200,000.00), upon the terms and conditions of this Agreement as a whole, payable as follows: ***

3. VanLandingham agrees to treat the sum of TWO HUNDRED THOUSAND and no/100 DOLLARS ($200,000.00) as ordinary income and Braun agrees to treat the sum as ordinary deduction.

4. The parties declare that these values were determined in good faith as the result of arm's length bargaining. The parties make the foregoing allocation of purchase price to the capital account of VanLandingham in VANLANDINGHAM, BRAUN & COMPANY, ($50,000), and VanLandingham's share in the noncapital assets in VANLANDINGHAM, BRAUN & COMPANY, ($200,000.00), with the knowledge and understanding that it will be used by Braun and VanLandingham for income tax purposes.

***

> 21. Each of the parties hereto agrees that they have received independent advice and counsel concerning the sale of the partnership business and the preparation of this Agreement and its terms and conditions herein contained.

The sales agreement also contained what is commonly referred to as a "covenant not to compete" or "noncompletion clause" wherein petitioner agreed i) not to provide accounting services, for a period of five years, within the Virginia counties of Gloucester, Matthews, Middlesex, York, King William, King and Queen, Lancaster, Northcumberland, Richmond, Westermoreland, or Essex; (ii) not to accept employment from any individual or association who was a client of the partnership as of October 22, 1976; and iii) not to solicit

clients within the above mentioned counties for a period of five years. If petitioner were to breach the covenant, Braun would be entitled to obtain injunctive relief and/or monetary damages plus attorney's fees. Prior to the sale, petitioner accompanied Braun on visits to major clients with whom Braun had little contact in order to personally recommend to them that Braun handle their accounting matters. Petitioner also sent out letters to all partnership clients in which he endorsed Braun's abilities as anaccountant.

The $25,000 cash payment called for in the sales agreement was paid by Braun to petitioner on November 15, 1976. The $25,000 note due March 1,

1977, was paid in full by Braun on or before March 1, 1977. Annual payments were made on the $50,000 and $150,000 notes, which constituted the remaining proceeds from the sale of petitioner's interest in the partnership, on July 1, 1977, July 1, 1978, and July 1, 1979.

On June 28, 1980, petitioner entered into a second agreement (hereinafter referred to as the "second agreement") with Braun, Eric R. Braun (hereinafter referred to as "Eric Braun")[4/] and Cynthia Braun.

The second agreement made reference to the November 1976 agreement and stated that the parties "hereto" are desirous that VanLandingham and Braun be relieved and released from any and all restrictions and allegations contained in said

agreement and that the notes mentioned therein be assigned to Eric R. Braun. The parties thereafter agreed; in pertinent part:

Eric R. Braun shall execute two notes payable to VanLandingham, the first note in the amount of $21,750.00 payable on or before June 30, 1980, the second note in the amount of $53,250.00 payable on or before July 31, 1981.[5/] Upon execution of these notes VanLandingham agreed to assign to Eric Braun all his rights in the notes provided for in the 1976 agreement, and simultaneously to deliver the assigned note to Eric Braun. It also provided "The party of the first part (Vanlandingham) agrees to treat the payment of $75,000 *** as capital gains and not as ordinary income." And

finally, VanLandingham and Robert Braun released each other from all of the terms and allegations of the November 13, 1976 agreement.

In accordance with the second agreement, Eric Braun executed and delivered to petitioner notes in the amounts of $21,750 due on or before June 30, 1980, and $53,250, due on or before July 31, 1981 (hereinafter respectively referred to as the "June 30, 1980 note") and the "July 31, 1981 note"). During petitioner's 1980 fiscal year, Eric Braun paid petitioner $21,750 in satisfaction of the June 30, 1980 note. During petitioner's 1981 fiscal year, Eric Braun paid petitioner $53,250 in satisfaction of the July 31, 1981 note.

Because of "domestic problems,"

petitioner moved to North Carolina several months after the sale of his interest in the partnership where he accepted employment with an accounting firm. Subsequently, petitioner moved to Whitestone, Virginia and then returned to Gloucester, Virginia in October 1982, at which time he reestablished an accounting practice there.

On February 23, 1981, petitioner filed his Federal income tax return for fiscal year ended June 30, 1980 and on June 7, 1982 filed his return for fiscal year ended June 30, 1981 with the Internal Revenue Service Center, Memphis, Tennessee. Petitioner reported the $21,750 payment and the $53,250 payment he received from Eric Braun as capital gain on his Federal

income tax return for the 1980 and 1981 fiscal years, respectively. On July 11, 1984, respondent sent to petitioner a statutory notice of deficiency in which he determined that the payments represented ordinary income to petitioner.[6/] The sole issue for decision is whether the $21,750 and $53,250 payments petitioner received from Eric Braun in the 1980 and 1981 fiscal years are ordinary income or capital gain.

Proceeds from the sale of an interest in a business are taxed to the seller as capital again or ordinary income based upon the nature of the assets sold. Proceeds are treated as capital gain with respect to that portion of the purchase price allocable to capital assets of the business.

Proceeds allocated to intangible assets such as goodwill are taxable as capital gain. Proceeds allocated to covenants not to compete are taxable as ordinary income. Ullman v. Commissioner, 264 F.2d 305 (2d Cir. 1959) affg. 29 T.C. 129 (1957). Frequently buyer and seller negotiate characterization of the business assets and state the resulting allocation in the document governing the sale. Generally, the seller wishes as little of the purchase price as possible to be allocated to the covenant not to compete since payments received by the seller for the covenant are treated as ordinary income. Conversely, the buyer wishes more of the purchase price to be allocated to the covenant not to compete because the buyer is thereby

entitled to deduct, by way of amortization, that part of the purchase price allocated to the covenant.

In this case petitioner treated the proceeds received from Eric Braun's payment of the June 30, 1980 note and the July 31, 1981 note as capital gain. In support thereof, petitioner argues that none of the proceeds are allocable to the covenant not to compete because: i) the covenant is ancillary to the sale of goodwill under the sales agreement and is not severable therefrom; and ii) the covenant is unenforceable under the laws of Virginia. Therefore, petitioner concludes, sales proceeds should be allocated entirely to goodwill, and other intangible assets capital in nature, producing capital

gain when sold.

Respondent argues the sale agreement clearly allocated the sales proceeds to the covenant not to compete and other noncapital items; that the allocation was the result of arms-length bargaining by knowledgeable parties; and absent "strong proof" to the contrary[7/] the allocation should be given weight for tax purposes. For reasons cited below, we agree with respondent.

We shall first consider enforceability of the covenant not to compete under the laws of Virginia. Petitioner cites the Virginia Supreme Court case of Meissel v. Finley, 198 Va. 577, 95 S.E. 2d 186 (1956), as establishing the standard by which such covenants are tested for enforceability

under Virginia law.[8/] That court stated the authorities on enforceability of noncompetition clauses constitute "a vast sea out of which one could fish out any kind of strange support for anything, if he lives so long" and further that "each case is to be determined on its own facts." The Meissel court then stated a three-part test by which enforceability of such covenants is to be measured. The test asks the questions (1) is the covenant "no greater than necessary to protect the (buyer) in some legitimate business interest;" (2) is the covenant "not unduly harsh and oppressive in curtailing (the seller's) legitimate efforts to earn a livelihood;" and (3) is the covenant "sound public policy."

95 S.E. 2d at 188.

By applying the above standard we find the covenant not to compete is enforceable under the laws of Virginia.[9/] Braun's "business interest" underlying the covenant not to compete was preservation of the income stream generated by the partnership. The purpose of the covenant was to protect that income stream by preventing petitioner from providing competing services in the same general area as existing partnership clients. The covenant did prevent petitioner from providing accounting services in four counties where the partnership did not then have clients. The four additional counties are York, Richmond, Westmoreland and Essex. However, we find it reasonable

for Braun to protect an area including a limited number of additional counties in close physical proximity to existing clientele. Each additional county is contiguous to, or surrounded by, counties with existing clientele. Westmoreland, Richmond and Essex counties are nestled between Northumberland, Middlesex and King and Queen counties. York county is directly across a relatively small inlet of the Chesapeake Bay from Gloucester County.

From the standpoint of petitioner, we find the covenant was not "unduly harsh and oppressive." Petitioner offers no evidence, nor even asserts, that the covenant created hardship or that petitioner disagreed with its application except as to its impact on

his Federal tax liability. Without any sign of misgiving, petitioner corresponded with all partnership clients and even visited major clients to recommend that Braun handle their accounting matters. Petitioner moved to North Carolina because of domestic problems. There is no evidence to suggest that the move was prompted by an inability to make a living due to enforcement of the covenant.

Under these circumstances, enforcement of such a covenant negotiated at arms length, reasonably limited in geographical area and duration is "sound public policy." The court stated in Meissel, supra at 191, "While the law frowns upon unreasonable restrictions, it favors the enforcement of contracts intended to protect

legitimate interests. It is as much a matter of public concern to see that valid engagements are observed as it is to frustrate oppressive ones."

We turn now to petitioner's arguments that the allocation of the purchase price in the sales agreement of 1976 was not to the covenant not to compete, but to a group of intangible assets including "the right to service all clients, noncompetition agreement and client files." Petitioner follows with the argument that this was intended to mean "goodwill" and that the covenant not to compete was ancillary to the goodwill and nonseverable therefrom. We cannot accept these arguments particularly in light of the fact that although a specific allocation of the purchase

price was made between two different groups of assets, one of which was clearly a capital asset, no mention was made of goodwill. Goodwill in a generic sense was probably intended to be included but we think it is reasonable to assume that as between these two parties, Braun was much more interested in protection from competition from the founder of the firm than the goodwill which the firm might have enjoyed and which it would probably retain in any event.

It is clear from the structure of the agreement that the two parties, both of whom undoubtedly had some familiarity with tax law, were both conscious of the tax implication of the allocation made. This is emphasized by the statements in the agreement that

the "values were determined in good faith as the result of arms length bargaining," that VanLandingham "agrees to treat the sum of *** ($200,000) as ordinary income and Braun agrees to treat the sum as ordinary deduction," that "The parties make the foregoing allocation of purchase price to the capital account of VanLandingham in *** (the firm) and VanLandingham's share in the non-capital assets (underscoring added) in *** (the firm) with the knowledge and understanding that it will be used by Braun and VanLandingham for income tax purposes," and that each party agreed that they had received independent advice and counsel concerning the sale and the preparation of this agreement. In addition the agreement specifically provided that if

Braun should breach this agreement in any manner the non-competition clause of the agreement "shall become null, void and of no further effect."

We conclude that the terms of the contract clearly express the intention of the parties that the $200,000 was allocated to the agreement not to compete and the rights ancillary thereto. We find that under the circumstances existing at the time the agreement was executed the allocation was realistic, particularly so far as Braun was concerned, had independent significance, and could be related to economic reality. Furthermore, respondent has so determined and petitioner has the burden of proving error in this determination.
Petitioner has failed to carry even

this burden, to say nothing of producing "strong proof" that the $200,000 was not allocated and not intended to be allocated to the covenant not to compete, as would be required by Ullman v. Commissioner, supra.

Petitioner does not claim the parties intended any allocation different from the one stated in the agreement. Petitioner did not take the witness stand in support of such a proposition nor did he call Braun or any third party who advised Braun or petitioner in structuring the sales agreement. The rule is well established that the failure of a party to introduce evidence within his possession which, if true, would be favorable to him, gives rise to the

presumption that if produced it would be unfavorable. Wichita Terminal Elevator Co. v. Commissioner, 6 T.C. 1158 (1946), affd. 162 F.2d 513 (10th Cir. 1947).

We also find the substitute agreement[10/] entered into June 28, 1980, between petitioner, Robert Braun and his wife Cynthia, and Eric R. Braun, supports our conclusion. In that agreement, executed at a time when the noncompetition agreement of 1976 had about a year and a half to run, the parties agreed that petitioner and Braun would each be released from any and all restrictions and obligations contained in the 1976 agreement, specifically including the noncompetition agreement, and that petitioner would assign to Eric Braun

all rights in the $50,000 note and the $150,000 note given to petitioner by Braun under the 1976 agreement, in exchange for which Eric Braun would execute two new notes payable to petitioner on June 30, 1980, and July 31, 1981,[11] totaling $75,000. For some unexplained reason, petitioner specifically agreed to treat the payment of the $75,000 as capital gain and not as ordinary income; nothing was said with regard to the payor's treatment of the payments. Thus petitioner received $75,000 rather than the remaining approximately $160,000 due on the two notes that were assigned, which would have been payable in installments up to 1991. Petitioner received no assets of the business. All that petitioner received in

exchange for his forgiveness of $85,000 of the existing debt was $75,000 cash payable in slightly over one year, relief from his covenant not to compete, and a statement in writing that he agreed to treat the $75,000 as capital gain, rather than ordinary income as he had been reporting the payments on the notes that he received prior to the execution of the 1980 agreement. Of course we have no evidence with respect to why this 1980 agreement was made or the circumstances surrounding same, but our best interpretation of the facts extrapolated from the agreement itself is that petitioner was willing to in effect pay (or forego receipt) of $85,000 for the right to practice accounting in his old bailiwick one

and one-half years before he could have otherwise, the right to receive the $75,000 within a year rather than over a period of 11 years, and an understanding in writing that he would report the $75,000 as capital gains. This could be taken to indicate that petitioner thought the covenant not to compete had considerable value independent of any goodwill.

Petitioner cites and relies on Horton v. Commissioner, 13 T.C. 143 (1949); Estate of Melnick v. Commissioner T.C. Memo 1961-18; and Karan v. Commissioner 319 F.2d 303 (7th Cir. 1963), affg. Estate of Melnick v. Commissioner, T.C. Memo 1962-129. We do not include here a summary of those cases because we find them factually distinguishable from the instant case.

As petitioner argues, these cases stand for the proposition that an accountant can have goodwill which he can sell to a third party. However, unlike the instant case, the purchase agreements in those cases contained no allocation of the purchase price to the assets transferred. In this case the sales agreement specifically allocated the purchase price among two groups of assets, one of which was referred to as the "capital account" of VanLandingham and the second of which was referred to as "VanLandingham's share in the noncapital assets in" the company.

We will not, under the circumstances present in this case -- a clear allocation resulting from arms-length bargaining by knowledgeable parties -- second guess the stated

allocation without strong proof to the contrary.

Decision will be entered for respondent.

FOOTNOTES

1/ All section references are to the Internal Revenue Code of 1954, as amended, and in effect during the taxable years in question, and all rule references are to the Tax Court Rules of Practice and Procedure.

2/ Petitioner concedes i) that the adjustment in the amount of $17,170.41 which respondent made with respect to his 1981 fiscal year gross income is correct; ii) that he is liable for the additions to tax pursuant to sec. 6651(a) for the 1980 and 1981 fiscal years for any deficiencies determined by the Court to exist with respect to income tax liabilities for those years (as stipulated); and iii) that he is liable for the addition to tax pursuant to sec. 6653(a) with respect to any deficiency for the 1981 fiscal year.

3/ The sales agreement was signed and dated November 13, 1976. However, a cash payment of $25,000, receipt and which was acknowledged by the parties in the sales agreement, was not actually made until November 15, 1976.

4/ The record is not clear whether Eric Braun is related to Robert L. Braun. In respondent's brief Eric Braun is referred to as "petitioner's father-in-law." Such relationship is immaterial to the issues before this Court.

5/ The parties stipulated that the second note was due on or before July 31, 1981. The second agreement,
Footnotes (Continued)

however, stated the note was payable on or before June 30, 1980. This note is not in evidence.

6/ Ordinarily, assessment and collection of any tax for fiscal year 1980 under these circumstances would be barred by the statute of limitations. However, the statute of limitations is an affirmative defense which, pursuant to Rule 39, must be set forth in the pleadings. Petitioner did not plead the statute of limitations as a defense in his pleadings nor has he mentioned the same in any proceeding or correspondence with this Court. Where a taxpayer falls to plead the expiration of the statute of limitations as an affirmative defense in his petition, the issue is not properly before this court. Dale v. Commissioner, T.C. Memo. 331-1981. We

6/ (Cont.) are unable to ascertain whether any of the exceptions to the statute of limitations which extend the Commissioner's authority to assess and collect tax beyond the normal three year limit apply in this case.

7/ Respondent asks the Court to adopt the rule of Danielson v. Commissioner, 378 F.2d 771 (3d. Cir. 1967), cert. denied 389 U.S. 858 (1967); that if the

terms of the terms of the contract are clear and unambiguous, respondent has the right to bind the parties to those terms, unless proof is adduced which would be admissible in an action between the parties to the agreement to

Footnotes (Continued)

show unenforceability because of mistake, undue influence, fraud or duress. In the alternative, respondent asks the court to apply the rule of Ullman v. Commissioner, 264 F.2d 305 (d. Circ. 1959), affg., 29 T.C. 129 (1957); that when the parties to a transaction have specifically set out the covenants in the contract and have given them an assigned value, strong proof must be adduced by them in order to overcome that allocation. The "strong proof" rule has, in the past, been preferred by this Court. Baldarelli v. Commissioner, 61 T.C. 44 (1973); Brauer v. Commissioner, 74 T.C. 1134, 1142 (1980). The result would be the same whichever rule is applied in this case.

8/ Meissel v. Finley, 198 Va. 577, 95 S.E. 2d 186 (1956), does not address enforceability of a covenant not to compete in the context of a sale of a business, but does address such a covenant in the context of an employment contract. Some jurisdictions allow greater latitude in enforcing covenants not to compete relating to the sale of a business than similar covenants in employment contracts. See Dalrymple v. Hagood,

246 Ga. 235, 271 S.E. 2d 149 (1980). Apparently Virginia makes no such distinction.

9/ We draw this conclusion while noting this Court is not bound by state law in assessing tax consequences of such transactions. Fidler v.
Footnotes (Continued)

Commissioner, T.C. Memo. 1980-346.

10/ This agreement was a stipulated exhibit with no objection from either party to its consideration in deciding this case.

11/ See fn. 5.

UNITED STATES TAX COURT
WASHINGTON

RALPH K. VANLANDINGHAM,	)	
Petitioner,	)	
v.	)	Docket No.
	)	34883-84
COMMISSIONER OF INTERNAL	)	
REVENUE,	)	
Respondent.	)	
	)	

D E C I S I O N

Pursuant to the determination of this Court as set forth in its Memorandum Opinion (T.C. Memo. 1987-66), filed February 2, 1987, it is

ORDERED and DECIDED that there are deficiencies in income tax and additions to tax due from petitioner as follows:

Year	Income Tax Deficiency
June 30, 1980	$ 2,609.41
June 30, 1981	10,085.60

Year	Additions to Tax Sec. 6651(a)	Sec.6653(a)
June 30, 1980	$130.47	$2,521.40
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W. M. Drennen
Judge

Entered: February 2, 1987

UNITED STATES COURT OF APPEALS

FOR THE FOURTH CIRCUIT

No. 87-1604

Ralph K. VanLandingham,
Plaintiff-Appellant

versus

Commissioner of Internal Revenue,
Defendant-Appellee

On Petition for Rehearing with Suggestion for Rehearing in Banc.

O R D E R

The appellant's petition for rehearing and suggestion for rehearing in banc were submitted to this Court. As no member of the Court requested a

2poll on the suggestion for rehearing in banc, and

As the panel considered the petition for rehearing and is of theopinion that it should be denied,

IT IS ORDERED that the petition for rehearing and suggestion for rehearing in banc are denied.

Entered at the direction of Judge Ervin, with the concurrence of Judge Wilkinson and Judge Wilkins.

For the Court,

____

Clerk

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 87-1604

Ralph K. VanLandingham,
Plaintiff-Appellant,

versus

Commissioner of Internal Revenue,
Defendant-Appellee.

Appeal from the United States Tax Court. Judge Drennen, Tax Court Judge. (Tax Ct. No. 34883-84)

Argued: December 2, 1987
Decided: January 4, 1988

Before ERVIN, WILKINSON, AND WILKINS, Circuit Judges.

Charles Richard Davis for Appellant; Linda E. Mosakowski, United States Department of Justice, Tax Division (Michael C. Durney, Acting Assistant Attorney General; Michael L. Paup; Gilbert S. Rothenberg on brief) for Appellee.

PER CURIAM:

Appellant Ralph K. VanLandingham appeals from a deficiency

order entered by the Tax Court. We affirm.

VanLandingham sold his interest in an accounting partnership to his partner, Robert Braun, in 1976 for $250,000. The sales agreement

provided that $50,000 was payable immediately while the other $200,000 would be paid over fifteen years. The agreement stated that $200,000 would be treated as ordinary income by VanLandingham and an ordinary expense deduction by Braun, and it also included a covenant by VanLandingham not to compete for five years.

A subsequent agreement in 1980 between VanLandingham, Braun, and Braun's father-in-law superseded the original agreement. Two payments totaling $75,000 from the father-in-law

replaced the unpaid balance of $160,000 from the initial agreement, and it released VanLandingham from the noncompetition agreement. It also

stated that VanLandingham would treat the $75,000 as capital gains, which he did.

The Internal Revenue Service disputed this treatment and issued a notice of deficiency. The Tax Court tried the case based on a fully stipulated record, and the sole issue at trial was the approariate tax treatment of the $75,000. The court determined that it was ordinary income and issued a deficiency order. VanLandingham appeals.

The Tax Court reviewed the evidence considering the intent of the parties and the economic realities of the transaction. Based on those considerations, it determined that the $200,000 was meant to be allocated to the noncompetition agreement and that

this intent reflected the economic realities faced by Braun and VanLandingham in their negotiations. The court therefore concluded that the $200,000 was ordinary income, and the $75,000 paid in lieu of it was the same.

We affirm the Tax Court's decision on the basis of the opinion below[1] and our previous decision in General Ins. Agency v. Commissioner, 401 F.2d 324 (4th Cir. 1968). The decision of the Tax Court is

AFFIRMED.

1 We do not necessarily endorse, however, the Tax Court's application of the strong proof rule, or its reliance on the failure to expressly reference "good will" in the sales agreement.

UNITED STATES TAX COURT

RALPH K. VANLANDINGHAM,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No. 34883-84

STIPULATION OF FACTS

It is hereby stipulated that, for the purpose of this case, the following statements are true and may be accepted as facts. All exhibits referred to herein and attached shall be considered authentic, and all copies shall be treated as if originals. Statements within the exhibits may be considered as evidence of the truth of the matter asserted. Either party may introduce other and further evidence not

inconsistent with the facts stipulated,

and either party may at trial object to the introduction of any part hereof solely upon the ground of claimed irrelevancy or immateriality.

1. The address of the petitioner at the time the petition herein was filled was P. O. Box 1238, Gloucester, Virginia 23061.

2. Petitioner filled his U. S. Individual Income Tax Return for the fiscal year ended June 30, 1980 (hereinafter "1980 fiscal year"), with the Internal Revenue Service Center, Memphis, Tennessee (hereinafter "Memphis Service Center"), on February 23, 1981. A copy of that return is attached hereto as Exhibit 1-A.

3. Petitioner filed his U. S. Individual Income Tax

Return for the fiscal year ended June 30, 1981 (hereinafter "1981 fiscal year"), with the Memphis Service Center on June 7, 1982. A copy of the petitioner's retained copy of that return is attached hereto as Exhibit 2-B.

4. On July 11, 1984, the respondent sent to the petitioner a statutory notice of deficiencies, a copy of which is attached hereto as Exhibit 3-C. The only adjustments in the statutory notice of deficiencies which are at issue in this case is the characterization of the payments which the petitioner received in the 1980 and 1981 fiscal years from Eric R. Braun (hereinafter referred to as "Eric Braun").

5. Petitioner concedes that the adjustment in the amount of $17,170.41 which respondent made with respect to his 1981 fiscal year gross income is correct.

6. Petitioner concedes that he is liable for the additions to tax pursuant to I.R.C. 6651(a) for the 1980 and 1981 fiscal years for any deficiencies determined by the Court to exist with respect to income tax liabilities for those years.

7. Petitioner concedes that on account of the conceded adjustment referred to in paragraph 5 that he is liable for the addition to tax pursuant to IRC 6653(a) with respect to any deficiency for the 1981 fiscal year.

8. On December

16, 1975, petitioner and Robert L. Braun (hereinafter referred to as "Braun") organized a partnership known as VanLandingham, Braun and Company (hereinafter referred to as "the partnership") to provide accounting services to the general public.

9. On November 13, 1976, petitioner and Braun entered into an agreement (hereinafter referred to as the "sales agreement") whereby Petitioner agreed to sell his interest in the partnership to Braun. A copy of the sales agreement is attached hereto as Exhibit 4-D.

10. The sales agreement provided that Braun would pay the $250,000.00 purchase price for Petitioner's interest in the partnership by making a payment of $25,000.00 in cash, and

executing, along with his wife, Cynthia L. Braun, a note for $25,000.00 due on March 1, 1977 and notes for $50,000.00 and $150,000.00 with regard to which principal payments of $10,000.00 and $3,333.33, respectively, were payable annually commencing on July 1, 1977 and ending on July 1, 1991. Copies of the notes are attached hereto as Exhibit 5-E.

11. The sale of the partnership under the terms of the sales agreement took place on November 15, 1976. Prior to the sale, Petitioner accompanied Braun on visits to major clients with whom Braun had had little contact in order to personally recommend to them that Braun should now handle their accounting matters. Petitioner also sent a letter to all clients in which

he endorsed Braun's abilities as an accountant.

12. Petitioner had practiced in the area served by the partnership for almost nine and one half years prior to selling his interest in the partnership. Braun, an accountant with six months experience in another State, joined Petitioner in his practice approximately three years prior to the sale of Petitioners' interest in the partnership.

13. Petitioner acquired the accounting practice from Frederick Ames in 1968. The gross revenue at the time Petitioner bought Mr. Ames' practice was approximately $37,000.00. At the time Petitioner sold his interst in the partnership to Braun, the gross revenue from the practice had grown to

approximately $280,000.00. During the same period, the number of clients grew from approximately 100 to 300. Approximately 40% of gross revenue in 1976 was attributable to several major clients in Middlesex County, a county in which Mr. Ames had provided virtually no accounting services. During the period commencing with the time Braun joined Petitioner in his accounting practice and ending on the date of Petitioner's sale of his interest in the partnership, no extraordinary growth in revenue occurred.

14. Approximately 87% of the $280,000.00 in gross revenue earned by the partnership at the time of Petitioner's sale of his interest in the partnership derived from the

provision of accounting services to individuals and businesses located in Gloucester and Middlesex counties. No services were provided in York, Richmond, Westmoreland, or Essex counties. The area represented by these counties is 846 square miles. Gross revenue of approximately $3,000.00 was earned from Northumberland, King and Queen, and King William counties and was attributable mainly to services provided to individuals not businesses, that is, no major clients were located in the counties. The area represented by these counties is 836 square miles. The area represented by Gloucester, Middlesex, Mathews and Lancaster counties is 653 square miles. The total of the area represented by all

the above counties is 2,335 miles.

15. Prior to the sale of petitioner's interest in the partnership, petitioner did not provide substantial accounting services to any client in connection with a transaction involving the sale of a client's business or the purchase of a business by a client.

16. After the sale of Petitioner's interest in the partnership, Braun continued to offer and still offers accounting services at the same location. Most of the clients previously served by the partnership are still served by Braun's accounting practice.

17. Because of domestic problems, Petitioner moved to Elizabeth City, North Carolina several months after the

sale of his interest in the partnership where he accepted employment with an accounting firm. On account of a family situation concerning the well-being of his mother, Petitioner moved to Whitestone, Virginia and then returned to Gloucester, Virginia in October 1982 at which time he reestablished an accounting practice. Of the 300 clients served by the partnership at the time of the sale of his interest in the partnership, approximately 35 are now served by Petitioner's accounting practice. These clients constitute a cross-section of clients previously served by the partnership.

18. The $25,000.00 in cash called for in the sales agreement was paid by Braun to the Petitioner on November 15,

1976.

19. The $25,000.00 note which the Petitioner received as a part of the proceeds from the sales agreement, due on March 1, 1977, was paid by Braun on or before March 1, 1977.

20. Annual payments as required by the contract were made on the $200,000.00 in notes which constituted the remaining proceeds from the sale of Petitioner's interest in the partnership. These payments were made on July 1, 1977, July 1, 1978, and July 1, 1979.

21. On June 28, 1980, Petitioner entered into an agreement with Braun, Eric Braun and Cynthia C. Braun. A copy of that agreement (hereinafter referred to as the "second agreement") is attached hereto as Exhibit 6-F.

22. In accordance with the second agreement, Eric Braun executed and delivered to the Petitioner notes in the amounts of $21,750.00, due on or before June 30, 1980, and $53,250.00, due on or before July 31, 1981 (hereinafter "June 30, 1980, note" and the "July 31, 1981, note").

23. During the Petitioner's 1980 fiscal year, Eric Braun paid the Petitioner $21,750.00 on the June 30, 1980 note.

24. During the Petitioner's 1981 fiscal year, Eric Braun paid the Petitioner $53,250.00 in satisfaction of the July 31, 1981 note.

FRED T. GOLDBERG, JR.
Chief Counsel
Internal Revenue Service

By: ______

______

MARION

B. MORTON

District Counsel

Post

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______

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______

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Freasier &

Associates, P.C.

3805

Cutshaw Avenue, Suite 512

Richmond,

Virginia 23230

______

______

C. RICHARD

DAVIS

THIS AGREEMENT made and entered into this 13th day of November, 1976, by and between RALPH K. VANLANDINGHAM, hereinafter referred to as VanLandingham, and ROBERT L. BRAUN, hereinafter referred to as Braun.

WHEREAS, under that certain Partnership Agreement of VANLANDINGHAM, BRAUN & COMPANY, executed on December 16, 1975, VanLandingham and Braun have carried on as partners the practice of public accounting; and,

WHEREAS, under the terms of the said partnership agreement, VanLandingham has an interest in the

capital and profits of the said partnership; and,

WHEREAS, Braun wishes to purchase al of the interest of VanLandingham in the said partnership and VanLandingham wishes to sell all of his interest in the said partnership,

THEREFORE, for and in consideration of the premises and the terms and conditions hereof, the parties agree as follows:

1. Braun agrees to purchase and VanLandingham agrees to sell the capital account of VanLandingham in the firm of VANLANDINGHAM, BRAUN & COMPANY for the sum of FIFTY THOUSAND and no/100 DOLLARS ($50,000.00), upon the terms and

conditions of this Agreement as a whole, payable as follows:

(a) TWENTY FIVE THOUSAND and no/100 DOLLARS ($25,000.00), upon the execution hereof, the receipt of which is hereby acknowledged, and

(b) TWENTY FIVE THOUSAND and no/100 DOLLARS ($25,000.00), together with interest thereon at the rate of EIGHT PERCENT (8%) per annum from the date of this Agreement, payable on March 1, 1977, a evidenced by that certain promissory note a copy of which is attached hereto and made a part hereof as Exhibit A.

2. Braun agrees to purchase and

VanLandingham agrees to sell the remaining interest of VanLandingham in VANLANDINGHAM, BRAUN & COMPANY, consisting of VanLandingham's interest in all intangible assets including but not limited to the right to service all clients, noncompetition agreement and client files, for the sum of TWO HUNDRED THOUSAND and no/100 DOLLARS ($200,000.00), upon the terms and conditions of this Agreement as a whole, payable as follows:

(a) FIFTY THOUSAND and no/100 DOLLARS ($50,000.00), together with interest thereon at the rate of SEVEN and ONE-HALF PERCENT (7 1/2%) per annum as evidenced by the terms of that certain promissory note a copy of which is attached hereto and made a part

hereof as Exhibit B, and

(b) ONE HUNDRED FIFTY THOUSAND and no/100 DOLLARS ($150,000.00), together with interest thereon at the rate of SEVEN and ONE-HALF PERCENT (7 1/2%) per annum as evidenced by the terms of that certain promissory note a copy of which is attached hereto and made a part hereof as Exhibit C.

3. VanLandingham agrees to treat the sum of TWO HUNDRED THOUSAND and no/100 DOLLARS ($200,000.00) as ordinary income and Braun agrees to treat the sum as ordinary deduction.

4. The parties declare that these

values were determined in good faith as the result of arm's length bargaining. The parties make the

foregoing allocation of purchase to the capital account of VanLandingham in VANLANDINGHAM, BRAUN & COMPANY, ($50,000.00), and VanLandingham's share in the noncapital assets in VANLANDINGHAM, BRAUN & COMPANY, ($200,000.00), with the knowledge and understanding that it will be used by Braun and VanLandingham for income tax purposes.

5. Braun agrees that each of the three notes payable to the order of Ralph K. VanLandingham will be made by himself and his wife, Cynthia C. Braun, and that he will not enter into a partnership, professional corporation,

or other form of business organization unless each of his future partners officers, directors and shareholders, together with his or her spouse becomes an endorser as to each note. It being the express intention of the parties that any such future partner, officer, shareholder and director shall, with his or her spouse, become personally liable for the debt evidenced by the aforesaid notes.

6. Braun further agrees that the aforesaid notes will be secured by life insurance policies on his life in such amounts as will pay in full the remaining outstanding balance, plus accrued interest. Such life insurance policies shall be payable to VanLandingham, and a copy of the receipt

for the premiums paid on such policies shall be made available to VanLandingham annually at his request.

7. Braun assumes and shall promptly pay when due all of the liabilities of VANLANDINGHAM, BRAUN & COMPANY as set forth in this paragraph, and, in addition, will indemnify and hold harmless VanLandingham from all such liabilities and for any and all liabilities arising out of work done for clients of VANLANDINGHAM, BRAUN & COMPANY after October 22, 1976. The parties hereto agree that there are no outstanding liabilities in excess of the liabilities listed in this paragraph. Any liability known by either party not listed in this paragraph shall be assumed in its entirety by the party

knowing of such liability, and such party shall indemnify and hold the other harmless from any liability thereon. The total outstanding liabilities of VANLANDINGHAM, BRAUN & COMPANY as of October 22, 1976, are:

$1,900.00	Payroll taxes
2,000.00	Estimated accounts payable
7,000.00	Note with First Virginia Bank of Tidewater
5,700.00	Overdraft, First Virginia Bank of Tidewater
3,700.00	Note with Chesapeake National Bank, Kilmarnock, Virginia
3,800.00	Note with Chesapeake National Bank, Kilmarnock,

1,064.25	Virginia Pitney-Bowes, estimated

8. Upon the signing of this Agreement, VanLandingham agrees to transfer to Braun the sum of THREE THOUSAND FIVE HUNDRED and no/100 DOLLARS ($3,500.00), as payment in full for VanLandingham's obligation in connection with the SEVEN THOUSAND and no/100 DOLLARS ($7,000.00) note with First Virginia Bank of Tidewater. Braun's signature to this Agreement certifies the receipt of this payment and Braun further agrees to secure a release from liability of VanLandingham and his wife from the said bank.

9. Braun shall do all things necessary to wind up the business of

VANLANDINGHAM, BRAUN & COMPANY, and prepare the final partnership tax returns in a manner consistent with prior tax returns, accounting methods and agreements.

10. VanLandingham agrees that any and all payments received by him after October 22, 1976, for services rendered in whole or in part by VANLANDINGHAM, BRAUN & COMPANY prior to October 22, 1976, shall be immediately forwarded to Braun. VanLandingham covenants that he has deposited to the credit of VANLANDINGHAM, BRAUN & COMPANY all payments received by him prior to October 22, 1976.

11. All rights, obligations, privileges and duties arising out of any

lease agreements, employment agreements, lease purchase agreements or any other agreements executed and binding upon VANLANDINGHAM, BRAUN & COMPANY as of October 22, 1976, shall be transferred to and assumed by Braun, and Braun agrees to hold harmless and indemnify VanLandingham from any and all liabilities arising from such contracts and agreements, providing the incident that gives cause to such liability occurs after October 22, 1976.

12. Braun agrees that VanLandingham has given his best efforts in good faith to promote the transfer of clients from VANLANDINGHAM, BRAUN & COMPANY to Braun. Braun acknowledges that VANLANDINGHAM, BRAUN & COMPANY in Braun's presence to promote the said

client transfer and that VanLandingham has mailed a letter approved by Braun to all other clients, a copy of said letter is attached hereto as Exhibit D. Braun

agrees that VanLandingham has fulfilled his obligation to promote the transfer of clients.

13. VanLandingham agrees for a period of five(5) years that he shall not directly or indirectly own manage, operate, control, be employed by, engage in, participate in, or be connected in any manner with the ownership, management, operation, or control of any public accounting or other accounting business located within the following counties: Gloucester, Mathews, Middlesex, York, King William, King and

Queen, Lancaster, Northumberland, Richmond, Westmoreland, or Essex, and the cities and towns located within the geographic or political boundaries thereof.

VanLandingham further agrees that he shall not accept employment either full or part time directly or indirectly from any client of the partnership who was a client of the partnership as of October 22, 1976.

VanLandingham covenants and agrees that he shall not directly or indirectly actively seek or solicit clients in the above mentioned counties for a period of five (5) years.

VanLandingham further agrees that

if advertising shall become permissible under the Code of Ethics for certified public accountants, then VanLandingham shall not advertise in any form of media located in or principally published in those counties mentioned in
this Agreement, located North of the York River.

14. VanLandingham agrees to be available for consultation and explanation on matters relating to client's work at the rate of $10.00 per hour, which rate shall include VanLandingham's travel time, if such consultation is requested by Braun. It is agreed by the parties that VanLandingham will not actually work on the client's matters, but shall only

consult with Braun or his designated agent. The provisions of this paragraph shall apply for a period of twelve (12) months from the date of this Agreement.

15. VanLandingham agrees that he shall execute and deliver any additional documents that may reasonably be required to assure Braun of all the assets of VANLANDINGHAM, BRAUN & COMPANY together with the exclusive right to its customer lists, books of account, contracts, correspondence files, and other similar items used in connection with the operation of VANLANDINGHAM, BRAUN & COMPANY.

16. The parties agree that except as otherwise provided herein

neither party shall bind or act as the agent for VANLANDINGHAM, BRAUN & COMPANY, unless specifically authorized by the other party.

17. Each of the parties hereto agree to waive his right to purchase the

life insurance policy upon his life owned by the other party, which policies were purchased pursuant to the partnership agreement. The parties hereto agree that all bank accounts in the partnership name have been closed and that neither party has claim against the other for any of the funds that were on deposit in such accounts.

18. Braun agrees to continue the current hospitalization, medical and

life insurance policies for VanLandingham for a period of six (6) months from the date of this Agreement, and VanLandingham agrees to pay to Braun the premiums attributable to the insurance coverage for VanLandingham.

19. Each and any of the following shall be considered a breach by Braun of the terms of this Agreement:

(a) Default in the payment under the terms of any of the said three notes by Braun and any additional makers or endorsers.

(b) Breach of any of the terms, covenants or conditions of this Agreement by Braun or any future partner, officer director or

shareholder, who are endorsers of this Agreement, provided, however, that Braun shall not be considered to be in breach if the violation is rectified within thirty days of the notice of such violation which notice shall be given to Braun by VanLandingham at the time VanLandingham learns of the said violation.

(c) Loss of Braun's license to practice as a Certified Public Accountant in the State of Virginia, if the loss of such license is for a period in excess of one (1) year, and if Braun is not in partnership with any other Certified Public Accountant.

(d) Braun's entry into a partnership, professional corporation,

or other form of business organization without securing the endorsement of all notes by each future partner, officer, shareholder, or director, and his or her spouse.

20. If Braun should breach this Agreement in any manner, then the following shall occur:

(a) The Non-Competition Clause of this Agreement Paragraph 13, shall become null, void and of no further effect.

(b) The provisions of the said Non-Competition Clause shall apply to any maker or endorser of the aforesaid notes attached to this Agreement who have been declared insolvent, bankrupt, who have made an assignment for the benefit of creditors,

or for whom a receiver has been appointed.

(c) All assets owned by Braun in his accounting business or owned by the firm, partnership, or professional corporation with which he is associated, shall become the property of VanLandingham but Braun shall receive as a credit on the aforesaid notes attached to this Agreement, payable to VanLandingham, an amount equal to the value of such assets, which value shall be determined by three appraisers. One of such appraisers shall be chosen by VanLandingham, one by Braun, and the third to be chosen by the first two appraisers.

(d) The lease between VanLandingham and his spouse, and BRaun, a copy of which is attached hereto as

Exhibit E, shall terminate as provided in the said lease.

However, none of the above shall be construed as precluding VanLandingham from exercising any other remedy at law or in equity that may be available to him. These remedies are cumulative and VanLandingham may pursue
one or more and shall not be required to elect one remedy to the exclusion of another.

21. Each of the parties hereto agrees that they have received independent advice and counsel concerning the sale of the partnership business and the preparation of this Agreement and its terms and conditions herein contained.

22. All notices, payments, claims or instructions shall be

delivered to each party at the following address until such time as the address is changed by giving written notice of such change to the other party:

VanLandingham
Mathews, Virginia
23109

Braun
Rt. 1, White Stone,
Virginia 22578

23. The parties hereto agree that any provision or provisions of this Agreement which may be inconsistent with the provisions of the Partnership Agreement of VANLANDINGHAM, BRAUN & COMPANY executed on December 16, 1975, shall prevail and be binding upon the parties hereto. It is the express intention of the parties hereto that this Agreement supersede and control the sale of the partnership interest of

VanLandingham to Braun.

24. Braun agrees that he shall not enter into a partnership, professional corporation or other form of business organization unless each of his future partners, officers, shareholders and directors, ratifies and affirms and agrees to become personally liable under this Agreement; and that neither Braun not his spouse nor any future partner, officer, shareholder, or director shall assign his or her rights, duties and obligations under this Agreement.

25. Braun agrees that he shall not enter into a partnership, professional corporation or other form of business organization unless each of his future partners, officers, shareholders and directors maintains or

has maintained a life insurance policy on such partner, officer, shareholder and director, which will be in an amount equivalent to the total ownership in such business by the said partner, officer, shareholder or director, and which shall be paid to the partnership, professional corporation or other form of business organization.

26. If VanLandingham breaches the non-competition clause of this Agreement, Paragraph 13, then Braun shall be entitled to: (a) injunctive relief against VanLandingham, (b) monetary damages plus reasonable attorney's fees, (c) either or both.

If VanLandingham (a) breaches any of the other covenants of this Agreement, (b) refuses to pay his share

of any debt or liability arising out of the partnership of VANLANDINGHAM, BRAUN & COMPANY, provided the incident that gives cause to such liability occurs prior to October 22, 1976, (c) either or both, then Braun and the other makers and endorsers of the aforesaid notes shall have the right to offset any such debt or liability or the monetary value of such breach from the payments to be made under the terms and conditions of the aforesaid notes.

27. This Agreement is made and is executed in duplicate, each copy of which shall be deemed an original.

28. This instrument contains the sole and entire Agreement between the parties and shall as of the date hereof supersede any and all other agreements between the parties. The

parties acknowledge and agree that none of them have made any representation to the other with respect to the subject matter of the Agreement of any representations inducing the execution hereof except such representations as are specifically set forth herein.

29. All references herein to VANLANDINGHAM, BRAUN & COMPANY refer to and shall be construed as referring to VANLANDINGHAM, BRAUN & COMPANY.

WITNESS the following signatures and seals:

____
Ralph K. VanLandingham

____
Robert L. Braun

____
Cynthia C. Braun

STATE OF VIRGINIA

COUNTY OF ______________________________,

to-wit:

The foregoing instrument was executed before me this _____ day of __________________, 1976, by Ralph K. VanLandingham, and by Robert L. Braun and Cynthia C. Braun, husband and wife.

My commission expires ______________________, 19____.

____
Notary Public